Leveraged Buyouts for Mid-Size Businesses

SAVANNAH, GA, UNITED STATES, February 23, 2021 /EINPresswire.com/ -- In the business world, the term “leveraged buyout” seems to carry a negative connotation. This is unsurprising considering the media dubbing them as “hostile takeovers” when reporting on them. However, the definition is rather simple: a leveraged buyout is a legitimate strategy for acquiring a new business.

Georgia-based real estate developer and hotelier, Charlton Claxton, has been using leveraged buyout for years with much success. He has found this practice is quite common, especially for mid-size businesses, and often leads to a win-win for both buyer and seller.

How It Works
When an individual is interested in purchasing a business but does not have the cash, equity, or investors required to do so, one option is to borrow part of the purchase price against that of the business’ assets.

The leverage buyout equation works something like this: assets + cash flow - debt. Of course, everyone must agree on the projected cash flow and sale price. Lenders look at the equation and this agreement under a microscope, and if something is not adding up, the deal will most likely fall through.

Assets
First thing’s first: assets should be calculated with careful attention paid to the balance sheet entries. Lenders have their own preferences about the worth of certain assets and how they should factor into the value to lend against.

The most valuable type of assets when it comes to leveraged buyouts are those that can be easily liquidated. This includes cash, accounts receivable, inventory, equipment, and property. All of which we’ll address below.

Cash & Accounts Receivable
Cash, of course, is liquid and immediately available to pay against the purchase price. Accounts receivable are factored, which comes with high financing rates. Lenders could offer up to 70-80% of the receivable’s value through another option of pledging. However, lenders could also entirely refuse to consider pledging on receivable for service companies on the grounds that there is no recoverable collateral.

Inventory
Loans are the name of the game for the raw materials and finished goods that are a company's inventory. For the raw materials, terms are based on their liquidity. High liquidity means more favorable financing. For finished goods, terms are mostly based on whether a warranty is issued.

Equipment & Property
Equipment can prove incredibly useful and support financing amounts possibly up to 70% of their original value, but the value of that equipment is again fodder for discussion and possible disagreement. Property actually values in the least variably but can sometimes, although rarely, support up to 90% of value into a loan.

Risks of Leveraged Buyouts
The biggest risk? Over-leveraging. The buyer might over-leverage the entire transaction leaving the company without adequate preparation to deal with unexpected issues, which are more than likely to arise.

Over-leveraging can also mean using operational financing to cover part of the actual purchase cost. The company could be left with minimal operational capital, since the bulk of invoice payments for the next month or two have already been allocated to pay the seller. This might mean delaying employee payroll or supplier payments, which in turn may cause a downward financial spiral for the business.

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